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Supreme Court of the United States

OCTOBER TERM, 1927.
No. 130.

THE EQUITABLE TRUST COMPANY OF NEW YORK as Trustee in Bankruptcy of KNAUTH, NACHOD & KUHNE,
Petitioner,

against

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,
Respondent.

REPLY BRIEF FOR PETITIONER

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I.

As to the Alleged Equitable Assignment.

As the result of 52 pages of argument on this point, the respondent contends that although the holder of the draft never knew of the existence of the drawing service, of K. N. & K.'s relation to the transaction, or of the Drafts Payable Account, nevertheless:

(1) By the advice from K. N. & K. to the B. C. I., followed by the debiting of K. N. & K.'s account and the crediting of the Drafts Payable Account, there resulted an equitable assignment of B. C. I.'s debt to K. N. & K. for the benefit of the holder of the draft. Respondent says at page 52:

> "Claimant has always claimed in the clearest terms and still claims that the assignment was an assignment *for the benefit of the holder of the draft, whoever he might be.*"

That statement is only confirmatory of the position now taken clearly by the respondent for the first time throughout its entire brief.

(2) That because the respondent as the drawer thereof has taken up the draft, respondent is subrogated to the rights of the holder. Respondent quotes with approval portions from the opinion in the *Mur'can* case, 13 Fed. (2d) 730, 732, decided at the same time as the case at bar, where the Court below said in distinguishing that case from this:

> "In Re Gubelman, Ex parte First National Bank of Trinidad, 13 Fed. (2d) 732, handed down today, we decided the drawer, having taken up a draft drawn under the same 'service contract', stood in the position of an equitable assignee. *It is true that this depended upon the drawer's subrogation to the holder's right, but the facts were not the same as here.*"

The errors in this argument, now so confidently advanced, are:

(A) That the law is elementary that there is no equitable assignment, and that there is in fact only a mere direction which is revocable, until the third party is notified of the supposed assignment either by the assignor or by the debtor (here the B. C. I.) and assents thereto, with the result that the risk of loss is thereafter on the third party;

(B) That even if there were an equitable assignment in favor of the draft holder, the Trinidad Bank has not been subrogated to the rights of the holder of the draft.

A.

In the absence of a notification and assent by the third party, there is no privity between the debtor and the third party. No *res* has been irrevocably appropriated and the instructions given to the debtor may be cancelled. In fact, the debtor, if he pays after such cancellation, would be liable to his creditor.

As pointed out in petitioner's main brief, the *power* to revoke—the *power* to transfer—is enough to pass title to the Trustee in Bankruptcy. The rule, as above stated, is well settled both in England and in this country; it is even recognized by counsel for the Fidelity Trust Company in its brief (p. 9) filed as *amicus curiae* herein. The reason for the rule is obvious. As pointed out by Judge Story in his *Commentaries on Equity*, Section 1045, and by Lord Ellenborough in *Williams* vs. *Everett*, 14 East 581, 596, the test of whether there is an equitable assignment depends upon the point at whose risk the so-called fund or *res* remains—who must stand the loss if the fund is lost. This being so, of course, that loss cannot be placed on the third party unless he has expressly, or impliedly at least, agreed to look to that fund or *res* as the sole source of his payment.

In England the Courts have gone far in denying to the holders of acceptances any rights against bankers to whom cash or bills were sent for collection to be used to take up the acceptances where the holders have not received notice that the cash or proceeds of bills are intended to constitute the source of the payment of the acceptances, and the holders have not consented to that arrangement.

Grant, Bankers & Banking Companies, page 258 (6th Edition, London 1910), in discussing special remittances to cover specific acceptances, states:

> "Rights of third parties. Where money has been paid to a banker by his customer for the purpose of taking up the particular bill, the question often arises whether the holder can claim to have the money applied in discharge of the bill. The answer depends upon whether any privity has been established between the banker and the holder of the bill. If none has been established, no action will lie against the banker either at law or in equity. *The mere fact of receiving money with oral or written directions to apply it in a particular manner will not bind the banker to third parties.* And where bankers having received money for the purpose of taking up a bill attended on the holder's agent for this purpose after the bill has been sent back as dishonored, they were not bound on the bill being subsequently presented to apply the remittance in payment of the bill. *The circumstance that the banker has appropriated the money in his books to payment of the bill is not sufficient to create privity between him and third parties.*"

Hart's, Law of Banking, 3rd Edition (1914) page 456, thus states the same principle:

> "But nothing short of an agreement on the part of the banker to hold funds to the use of the payee, *communicated to the latter*, will render the banker liable to him. The receipt of specific funds by bill or otherwise from his customer, with express directions to apply such funds in meeting a particular draft, will be insufficient for this purpose, even although the customer has himself communicated to the holder the instructions given to the banker, and the banker has also in guarded language, and avoiding an undertaking to pay, informed the payee of the instructions which he has received."

The law on this point was summarized, as far back as 1811, by Lord Ellenborough in *Williams* vs. *Everett*, 14 East. 581, where he said.

> "It is entire to the remitter to give, and countermand, his own directions respecting the bill as often as he pleases, and the persons to whom the bill is remitted may still hold the bill till received, and its amount when received, for the use of the remitter himself, *until by some engagement entered into by themselves with the person who is the object to of the remittance*, they have precluded themselves from so doing, and have appropriated the remittance to the use of such person."

The American authorities are to the same effect:

> 3 *Pomeroy, Equity Jurisprudence*, Section 1281 (4th Edition) quoted at page 16 of petitioner's principal brief;
> *Story, Commentaries on Equity*, Section 1045;
> 1 *Williston on Contracts*, Section 436.

The respondent recognized that notice to the assignee is a *sine qua non* of the assignment, by italicizing its statement of the additional facts which would have turned the situation in the *Interborough* case into one resulting in an assignment, for at page 34 of its brief, it says:

> "The court expressly recognized that if the creditor *were told of the setting apart and assented thereto*, a different situation would arise • • •."

In the light of these authorities, it is evident that the holder of the drafts who never knew that K. N. & K. was in the transaction, never knew of the "drawing service" and never knew of the Drafts Payable Account, could not have become an equitable assignee of the indebtedness of B. C. I. to K. N. & K. and could not have assented to look "to that fund" as the sole source of

the payment of the draft. Therefore, as there was no equitable assignment, the mere instructions given by K. N. & K. to B. C. I. were revocable—K. N. & K. at all times retained the power to transfer B. C. I.'s indebtedness to them and that indebtedness accordingly passed to the Trustee in Bankruptcy.

The error of the court below in deciding that the holder of the draft was an equitable assignee was emphasized in the *Zimmerman & Forshay* case decided on the same day where a like conclusion was reached even in the absence of a drawing service contract and as a result of the drawing of a draft by the bankrupts themselves. Clearly the court below overlooked the foregoing elementary principles.

B.

Even if on any conceivable theory the holder of the draft became an equitable assignee, it has not been explained how the respondent acquired the holder's rights, by subrogation or otherwise.

The Circuit Court of Appeals, in the *Munteau* case, expressly stated that the respondent's rights in the present case rest upon subrogation to the rights of the holder. But the opinion does not explain how the doctrine of subrogation is applicable to the present facts. If there were an equitable assignment with the result that "the fund" abroad belonged to the draft-holder, then his remedy was against the B. C. I. and the respondent as the drawer was not in default and was under no obligation to take up the draft. If this is so, the taking up of the draft by respondent was a mere voluntary act on its part which would gave it no right to subrogation. No citation of authority is needed for the proposition that unless there is a duty to pay, there can be no subrogation.

The Bankrupts' Right to Cancel and the Payment of the Balance by the B. C. I. to the Trustee in Bankruptcy.

Since the respondent here by its own argument has simply acquired the rights of the draft-holder and it has been shown that there was no *res* irrevocably appropriated for the benefit of the draft-holder, it follows that, even assuming the subrogation claimed by the respondent, no *res* came into the possession of the Trustee in Bankruptcy charged with the payment of the draft. Just because the B. C. I. had never notified the draft-holder of the existence of the Drafts Payable Account, and because the draft-holder had never expressly or impliedly agreed that the risk of loss of the fund was on the holder, and just because the B. C. I. recognized that until such notification and acquiescence the fund, to wit, B. C. I.'s indebtedness to K. N. & K., still belonged to K. N. & K. and was at its risk, *the B. C. I., despite the bankruptcy, recognized its obligation to pay its indebtedness to K. N. & K. and to no one else.* And, of course, the foreign bank in the *Zimmerman & Forshay* case evidently made payment to the Trustee in Bankruptcy in that case for like reason.

But, here, the petitioner need not rely on the mere negative argument that the holder never consented to the "assignment". For not only was there no notification to the draft-holder or consent by him, but in addition, *the uncontradicted testimony is that a custom existed by which the bank which advised the protected draft retained the right to cancel such advice.* In all probability this very custom grew out of the fact that until the draft-holder was notified, the right of cancellation existed.

Respondent points out that according to the record the bankrupts *had* never cancelled an advised draft ex-

cept at the request of the bank drawing the draft, and the respondent would argue from this fact that the bankrupts only had the *right* to cancel when they had been so requested. As a matter of pure reason, respondent's argument can be disposed of by pointing out that in the absence of insolvency, the bankrupts would never have had occasion to cancel a draft once advised by them, unless the drawer bank requested the cancellation. The bankrupts before advising a draft had received payment for their services in American dollars. Having received this payment, they would never desire to cancel the draft abroad except when they intended to return the American dollars paid here by the drawer. Had the bankrupts prior to the bankruptcy cancelled an advised draft without the request of the drawer, they would have been bound to repay the dollar consideration received. As a matter of law, respondent's argument may be disposed of by pointing out that the mere fact that the bankrupts never *did* cancel without having received the request of the drawer to do so, has no bearing whatever upon their *power* to do so, thus enabling them to use once more their balance abroad, leaving the drawer bank only with a general claim against the bankrupts for the amount of the consideration originally paid for the protection of the draft. This claim, in the absence of insolvency, the bankrupts would, of course, have paid out of their general funds and not out of any specific fund.

A similar argument was recently advanced to this Court by the respondent in the case of *Equitable Trust Company* vs. *Rochling*, decided November 21, 1927, where it was argued that because the respondent there *never drew* against a balance with its banker until the checks deposited to its credit had been collected, it did not have the *right* to do so. The argument was ignored by this Court which evidently held that the right existed, despite the respondent's failure to exercise it.

As to the Drafts Payable Account.

Even if the practice of the banker in earlier times of setting aside cash of his own to meet drafts drawn upon him were in use today, nevertheless, under the rules above stated, there would be no equitable assignment in favor of the holder of the draft and the instructions to pay could be cancelled at any time. At best he would be holding that cash because of his contractual commitment *to his depositor*, the drawer, and not because of any obligation to the payee.

Despite the wholly clear testimony of Mr. Dawson at folio 368, quoted at length in petitioner's principal brief at page 37 that the foreign bank cancels the advice at the request of the person who has the account in the bank, *whether he is the drawer of the draft or whether he is the person who advised the draft drawn by somebody else*, and despite Mr. Dawson's clear statement that his prior testimony in which he was there speaking of the drawer of the draft where no third party was involved, nevertheless, the claimant now seeks to urge that the foreign bank would only cancel advices where the drawer "wished to have that result accomplished," and that the drawer was not "the person" who had the account in the bank, but the person whose draft was being protected. From this premise, claimant seeks to build up the argument that B. C. I. would cancel an advice only at Trinidad's request and that, therefore, the power to cancel did not rest in the Receiver, or more accurately, did not exist at the time of the filing of the petition. It is needless to review Mr. Dawson's testimony again. This was done at pages 35, *et seq.* of the principal brief. Attention should, however, be called to the stipulation at folio 378:

> "Whenever, prior to the payment of a draft which has been advised abroad in the form of Ex-

hibits 6 to 6E, the *bankrupts* notified the Banca Commerciale Italiana to cancel any specific advice or advices, or to stop payment on any draft or drafts covered therein, Banca Commerciale Italiana forthwith re-credited the *bankrupt's* account with the amount of said draft or drafts, and at the same time debited the account termed 'drafts payable' for the same amount. This was done without knowledge on the part of Banca Commerciale Italiana as to whether such draft or drafts were in the position of the bankrupts, the drawer banks or third parties."

In the light of Mr. Dawson's testimony and the foregoing stipulation, it is again urged there is no justification for the limitations which the respondent seeks to impose on the bankrupt's power or right to cancel advices.

Absence of Advice to K. N. & K. of Payment of Drafts Immaterial.

Respondent seeks to make much of the fact that in the drawing service it is stated that the payment of drafts abroad was not usually reported to K. N. & K. and that they could only ascertain whether or not drafts had been presented for payment by making special inquiry to the drawee bank. They also refer to the fact that the statements rendered by the B. C. I. to K. N. & K. show only K. N. & K.'s balance in their general account and not the balance credited to the Drafts Payable Account. Respondent suggests the implication that that was the practice because of the fact that the amounts credited to the Drafts Payable Account were irrevocably appropriated for the payment of drafts. The fact is that the bankrupts having been paid in American dollars, considered that portion of their balance abroad which was credited to the Drafts Payable Account in

the same category as that portion of a bank balance against which a check has been drawn Whether or not the check has been presented, a careful banker considers as the balance available for his business only his "check book balance"—that amount not yet drawn against. This is so, despite the fact that he at any time may stop a check, or even without stopping a check, draw against the balance represented by it, and in the event of his bankruptcy, the balance is not deemed appropriated to outstanding checks.

In the case of drafts advised abroad, either the banker's own drafts or those drawn under "his protection," the banker assumes that both will be presented in due course for payment, and therefore, having advised the foreign bank of the drawing of both kinds of drafts, he is no longer interested in being advised of what his balance is, beyond the balance in excess of the drafts advised. For this reason, there is no need of the foreign bank to render a statement showing anything but the balance over and above the aggregate of advised drafts. But from this fact, it does not follow that the right to cancel advices does not exist. As already shown, that power, in fact, does exist until the foreign bank or the banker here notifies the holder of the supposed equitable assignment by the appropriation of a fund.

Again, reference is made to the fact that certain drafts were not debited to K. N. & K.'s general account and credited to the Drafts Payable Account "through lack of funds" in the general account, and from this fact the inference is sought to be drawn that an actual transfer of funds was intended from one account to the other. But this situation is no different than it would be in the coupon cases or in any case where two accounts are maintained. If, in fact, the funds in the general account were insufficient, then, of course, as a matter of bookkeeping, the other account could not be credited with the amount

of the draft any more than a coupon account could be credited with moneys from the general account, if the latter account, in fact, contained no credit balance.

The Risk of Loss at All Times Remained With K. N. & K.

At pages 46 and 47 of its brief, respondent asserts that it is interesting to observe that the Trustee has omitted from its brief in this court the question which it asked in the court below, namely, whether the respondent seriously argued that the intention under the drawing service was that the large and small banks throughout the country which had no knowledge of foreign banks, paid over their money relying upon the credit and responsibility of the foreign correspondent unknown to them and chosen by K. N. & K. From this supposed omission, respondent seeks to draw the conclusion that this most potent argument has been abandoned. Had respondent read petitioner's brief with ordinary care, it would have found the question repeated verbatim at the bottom of page 40 of that brief. The answer which the respondent makes to the question is, in fact, no answer at all.

It is stipulated (fol. 70) that the rate fixed by K. N. & K. included a sum estimated as sufficient to compensate K. N. & K. for the service, and of course, in fixing that profit, the danger of the failure of the foreign bank must have been taken into account. It is well known that even where bankers draw their own drafts and where they remain liable as drawers, their profit is exceedingly small in each individual case and is made up by the volume of the business.

Respondent admits at page 63 of its brief, that under the provisions of the drawing service at folio 434, the rate upon which a draft would be *sold* was fixed by K. N. & K. "*upon the same basis*" as the rate upon

which it would agree to *provide for the payment* of drafts drawn under the drawing service, to wit, the market price of the foreign currency involved. This being so, there is, of course, no reason why the obligation assumed under the drawing service should not be as great as in the case where K. N. & K. were liable as the drawers of the draft.

Certainly there is no evidence that the profit which the *Trinidad Bank* made upon the transaction was so large that they, rather than K. N. &. K., could take the risk of the failure of banks upon which they drew drafts. As between the Trinidad or other inland banks and K. N. & K., the latter could certainly afford to take the risk, inasmuch as they had chosen the correspondents and had contacts abroad through which they constantly could be advised as to the necessity of changing their list of correspondents.

As to Respondents' Authorities.

In all of the cases relied on by respondent the assignee had knowledge of the appropriation of a *res* to the satisfaction of the obligation due him. In fact he himself had contracted for the appropriation of that *res*. In the present case as has been pointed out the draft-holder —the alleged assignee never had any knowledge of the service contract, the existence of K. N. & K. or of the alleged *res*—the Drafts Payable account. This is a distinction which exists in addition to those already pointed out in petitioner's main brief, at p. 54.

In the *Yardley* case, 165 U. S., 634, it appeared that the equitable assignee itself was informed by the Philadelphia Bank that the New York bank account was in fact the security for the check which had been drawn. Accordingly, the situation was the same as if the legal assignment had, in fact, been made, which of course would

be effective without any consent of the New York bank.

In *Coates* vs. *First National Bank*, 91 N. Y., 20, it appeared that the Masten Bank, being requested to establish the credit in New York for the Salina Bank, advised the Salina Bank that the remittance had been made (91 N. Y., at 22).

In *Muller* vs. *Kling*, 149 App. Div., 176, affirmed 209 N. Y., 239, the transaction was between the assignor and the assignee, and as pointed out by Judge Miller in the Appellate Division, the assignee parted with his money upon the faith and security of an existing debt. So too, in *Hackett* vs. *Campbell*, 10 App. Div., 523, an assignment was delivered to the assignee.

II.

As to the Alleged Initial Trust Relationship.

The provisions of the drawing service, which bear on the respondent's contention that the American dollars paid K. N. & K. were initially received in trust, have already been analyzed *in extenso*. The cases relied upon by the respondent are not, generally speaking, cases dealing with foreign exchange transactions and are not even remotely analogous in their facts to the present situation. In addition, they are cases which contain an earlier and different approach to the problem of a banker's obligation, than such recent cases, discussed in the principal brief, as the *Leguia* and *Gravenhorst* cases in New York, the *Beecher* case in Massachusetts, and *Katcher* vs. *American Express Company*, 94 N. J. L. 165 in New Jersey. This fact was recognized by *Mr. Justice Stone* in his article in the *Columbia Law Review* to which reference has already been made, for he says at page 520:

> *"The recent decision of the courts of New York and New Jersey in the case of foreign exchange*

holding that the obligation of the banker is contractual only, evidence a more just appreciation and exact appraisal of the importance of the method of conducting the banking business in determining what the undertaking of the banker is. The principle of decision in those cases ought to be extended and applied generally to those cases where bankers undertake to effect payments of money for account of their customers in the ordinary course of the banking business whether the exchange element is present or not.

"The extension of the rule in the *Legniti* case generally to all cases of deposits of funds with a banker for transmission where there is no stipulation that the banker shall keep the deposit segregated as a trust fund, would not in any way limit the application of the rule that, when property other than current funds is received by the banker for account of his customer, it is to be treated legally as a quasi-trust fund. We have already seen that paper entrusted to a banker for collection is so held by him, although he is treated as only a debtor for the proceeds when collected. Bankers do not customarily use such property in their general business as bankers hence there is no custom or practice to rebut the common law presumption that such property is received in a fiduciary capacity."

Even within the scope of their facts, the soundness of the conclusions reached in most of the cases relied upon by the respondent has been questioned by Mr. Justice Stone, for at page 516 of the aforesaid article, he says:

"In many of the United States, on the other hand, the courts, disregarding the customary method of transmitting funds by bankers have applied the usual presumption, when moneys are deposited with a private individual for payment over to a third person and held the depositary liable as a fiduciary. From the application of this rule it follows that the person entitled to the credit is a preferred creditor who may claim

priority of payment over general creditors. And in a number of instances a banker, where an individual, on failing to effect the payment to the payee has been held guilty of embezzlement or of larceny under those modern statutes which are broad enough to embrace embezzlement. He is also subject to civil arrest where that process, as in New York, is applicable in the case of a breach of the fiduciary obligation. There can, of course, be no question but that a fiduciary of moneys who appropriates those moneys to his own use is guilty of embezzlement. *But to hold that a banker receiving money before his known insolvency, for transmission in the ordinary course of the banking business is guilty of larceny merely because of his failure to perform his undertaking or because he has placed the moneys thus received with his general funds and used them as such, would seem to be tantamount to holding that a banker who fails to pay his general depositors or who uses general deposits in his banking business is guilty of larceny.* Criminal liability necessarily follows if the deposit is received in a fiduciary capacity. *But there is no basis for the inference that it is so received if there is no stipulation that the moneys are to be held any differently than other funds deposited with the banker and upon his credit.*"

In the footnote to the comment just quoted there are cited, among others, as a subject of the discussion, the following cases relied upon by the respondent:

People vs. *The City Bank of Rochester*, 96 N. Y., 32;

Cutler vs. *American Exchange Bank*, 113 N. Y., 593;

Massey vs. *Fisher*, 62 Fed., 958.

The foregoing New York cases were pressed upon the New York Court of Appeals in the *Legnitz* case (see

synopsis of argument in that case) and were apparently deemed so inapplicable to the problems arising from the recently developed foreign exchange transactions as not even to require consideration by the Court.

Rationale of Legniti Case.

It has already been pointed out in the footnote at page 81 of petitioner's main brief and in the quotation from Mr. Justice Stone's article made in this reply brief, that the imposition of a trust obligation on a banker under any circumstances is questionable. It is clear, however, that the authorities have already restricted the application of such an obligation to those cases which are strictly so-called "transmission" cases, i. e., in which the customer gives to his banker a sum in American dollars, which very sum he desires to have transmitted abroad. Of course he realizes that the payment, when made abroad, will be made in the currency of the country where the payment is made. However, what he desires and contracts for primarily is the transmission of the given amount of American dollars, or *its* foreign equivalent. On the other hand, where the customer contracts with his banker for the payment abroad of a definite amount in foreign currency—where the parties are thinking in terms of a foreign credit in the foreign currency—the sum paid by the customer to the banker is simply the consideration for the payment of the desired and specified foreign amount or for the creation of the desired and specified foreign credit; a sum calculated by the dollar equivalent of the foreign currency amount desired. In the first case the customer in effect says: "Here is $100. Pay it (by means of its lire equivalent) to my mother in Milan." In the second case the customer in effect says: "I want 2,000 lire available to my mother in Milan; here is $100, the dollar equivalent at

existing rates." This is the very distinction at the basis of the *Legniti* case for the Court there said:

> "This was not the case of a specific sum of American money being sent to Naples after being exchanged for lire. It was a case of 18,000 lire being needed in Naples and the purchase of A. Bolognesi's credit with the Banca Commerciale Italiana for this amount * * *"

The Court then held that the situation referred to in the first sentence involving "a specific sum of American money" presented a trust relationship whereas the second situation did not.

Applying the foregoing principles to the present case, it requires no argument to show that Trinidad Bank in effect said to K. N. & K., "We want 24,360 lire available at the Sassari Branch of the B. C. I."—for it had drawn its draft for a definite amount of lire. It therefore could not have been thinking in terms of a specific sum of American dollars but rather in terms of a specific sum of Italian lire.

In the light of this analysis it is urged that there exists no basis for the contention that the American dollars were paid to K. N. & K. for "transmission" to Italy.

The respondent has agreed at page 67 of its brief that the use of the words "principal" and "agent" is not controlling. The sole question, therefore, is what was the relationship resulting from the circumstances. Were the American dollars received in trust for transmission. That they were not, within the test laid down by the *Legniti* case and followed in Massachusetts, has just been shown.

It appears that all the cases relied upon by the respondent were cases where the bank's customer directed the bank to remit or forward a particular sum in American dollars usually for a particular purpose.

In *In re Bolognesi* (C. C. A. 2nd 1918) 254 Fed., 770, upon the bankruptcy of A. Bolognesi & Co., there were presented to the Court the reclamation claims of two distinct classes of creditors—(a) those who had given moneys to the bankrupts for a specific purpose, to wit, either "investment" or transmission abroad, and (b) those who had purchased and received from the bankrupts foreign drafts. In the first class of cases the Court held that the relationship between the customer and Bolognesi was one of trust; that the money was given for investment purposes and that the relationship was no different than that in *Johnson* vs. *Brooks*, 93 N. Y., 337, where the plaintiff gave money to his broker for the purchase of certain named stocks, and the stocks came into the possession of the broker. In the second class of cases, however, where the draft had been purchased and issued, this Court held that the transaction was executed, that the customer procured exactly what he had bargained for, namely, the general obligation evidenced by the draft. That case, therefore, dealt only with situations within classes 1 and 3 analyzed at p. 80 of petitioner's principal brief and in no wise involved a contract for the establishment of a credit abroad.

Similarly, in *In re Jarmulowsky* (C. C. A. 2nd 1919) 258 Fed. 231 the customer gave to the banker $288.00 "to be forwarded" to the customer's designee. This comes clearly within Class 3, for, to use the language of Judge CRANE in the *Legniti* case,

> "it is the amount which he gives that is to be transmitted."

Farley vs. *Turner* (1857), 26 L. J. Ch. 710, is fully discussed in petitioner's brief filed in reply to the brief submitted by the Fidelity Trust Company as *amicus curiae*.

In *City of St. Louis* vs. *Johnson* (1879) 5 Dillon 241,

the City of St. Louis handed a check for $173,000.00 to a Missouri bank with a letter which stated

> "which you will please have *remitted to New York* to pay bonds and coupons of the City and County of St. Louis falling due in May proximo."

Here again was a case which in its essence was a transmission case with no obligation to establish a credit but with definite instructions to apply the money to take up the coupons.

That *People* vs. *The City Bank of Rochester* (1884), 96 N. Y., 32, is a remission case and that there money was given for a specific purpose is made clear by the following statement in the Court's opinion at p. 36:

> "The object of the latter was to provide a fund for the payment of specific notes, and the engagement of the former was to apply *that fund* to such payment."

In the case at bar Claimant's Exhibit 4, which contains respondent's instructions to K. N. & K., was a direction merely to "protect" the draft upon presentation and enclosed a check in dollars to pay for that protection "upon presentation." In strict accordance with these instructions Claimant's Exhibit 6 shows that the main office of the foreign bank was merely directed to "protect" the draft and to charge to the account of *K. N. & K.* and the branch was instructed to "honor" the draft and charge the draft to the account of Knauth, Nachod & Kuhne with the main office (Exhibit 6B, fol. 493). Certainly from these documents it is impossible to spell out an engagement or an intention to hold a fund in trust for the payment of the draft. If that had been the intention it would have been very easy for the Trinidad to have said in its advice,

> "We enclose our check for $1,191.20, which please remit to our credit in the B. C. I."

and for K. N. & K. to have directed the establishment of a credit in the name of Trinidad.

In *Cutler* vs. *American Exchange National Bank* (1889), 113 N. Y., 593, the plaintiff, wishing to "remit a sum of money to one Hall in Leadville" paid to the defendant the sum of $500.00 and received in writing a statement addressed to the Bank of Leadville to the effect that the bank's account with the defendant bank had been credited with $500.00 "for the use of J. Seymour Hall." The plaintiff forwarded this letter to Hall and before its receipt the Leadville bank failed. Plaintiff demanded the return of his $500.00 from the defendant which the defendant refused to pay. This case does not differ from the others which the respondent has relied upon. Clearly the money was paid to the defendant bank for the purpose of remission to the Leadville bank for a specific purpose. As above indicated this case was ignored by the Court of Appeals though pressed upon it in the *Legniti* case.

In the last case relied upon by the respondent, *Massey* vs. *Fisher* (C. C. Pa., 1894), 62 Fed., 958, the Court expressly followed the *Bank of Rochester* case and held that where money was deposited with a bank for the specific purpose of using that money to take up the note of a depositor the money was received in trust for that purpose.

The Foreign Balance Was Not a "Transmuted State of the Money Remitted."

Respondent concedes in its Point III, p. 111, that irrespective of the theory upon which it proceeds, it must trace a specific *res* into the Trustee's possession. In order to accomplish this with respect to the American dollars which respondent claims were paid to K. N. & K. in trust, it is forced to assert in its Point IV, p. 112 that

"the fund abroad was but a transmuted state of the money remitted by claimant to K. N. & K."

Just what this means petitioner is unable to determine. Even if respondent has established the existence of an initial trust, it must then show that the original *res* (the American dollars) or their proceeds (property acquired therewith) is now in the Trustee's possession.

> *Cunningham* vs. *Brown* (1924), 256 U. S., 1, 11;
> *Duel* vs. *Hollins* (1916), 241 U. S., 523;
> *Schuyler* vs. *Littlefield* (1914), 232 U. S., 707.

For the foreign balance to be the "proceeds" of the American dollars paid, that foreign balance must have been acquired by K. N. & K. by using the very American dollars to purchase the foreign currency credit. Unless this is shown, there has been no "tracing" within the cases just cited. *There is not a scintilla of evidence in the record to justify this conclusion,* and irrespective of the nature of the relationship, respondent's claim based upon the existence of an initial trust must fail for lack of tracing.

III.

The Rights of the Parties were Fixed as of the Filing of the Petition in Bankruptcy.

In petitioner's main brief, Point III, the petitioner argued that under Section 70a (3) and (5) of the Bankruptcy Act, the debt from the B. C. I. to K. N. & K. vested in the Trustee as of the filing of the petition in bankruptcy and that the rights of the parties were fixed as of that date. In its Point V, the respondent "agrees with the petitioner that the rights of the parties became

fixed upon the filing of the petition in bankruptcy and that the subsequent acts of the Receiver cannot change those rights." Despite that "agreement" the respondent at pages 9 to 11 of its brief, attempts to argue that the correspondence between the Receiver and the B. C. I. after the bankruptcy contained admissions against, or in other ways affected, the petitioner's contentions. It is unnecessary here to do anything more than refer to the complete argument made by petitioner in Point III, page 87 of its main brief, and to point out as has been done the inconsistency existing within the Respondent's brief.

The "concession" made by the respondent of the existence of the rule of law that the rights were fixed as of the date of bankruptcy was for the purpose of claiming that the cancellation of the advices by the Receiver after the bankruptcy could not give the estate and the general creditors any rights in addition to those which they had at the time of the filing of the petition in bankruptcy. Petitioner does not claim that the Receiver's acts resulted in any additional rights of the estate. Petitioner's argument set forth at length in the main brief is that since on the date of the filing of the petition in bankruptcy, the bankrupts had the power to cancel the advices and to transfer their balances abroad, those balances were property which passed to the Receiver or Trustee in Bankruptcy and which could be collected by him at his request.

IV.

The Correspondence with Thomas B. Paton.

It is hardly conceivable that counsel should have deliberately placed before this Court the correspondence between the Receiver and Thomas B. Paton, Esq., General Counsel of the American Bankers Association, re-

ferred to at pages 90 to 95 of respondent's brief. In the first place that correspondence was never offered in evidence, the Trustee in Bankruptcy was never offered an opportunity to explain or rebut it, and the fact that it was improperly used was pointed out to respondent's counsel when they first presented it in their briefs before the Circuit Court of Appeals. In the second place, when that correspondence was first used before the Circuit Court of Appeals, it became necessary for the Trustee's counsel to print as an appendix to their brief a letter which completed the correspondence between the Receiver and Mr. Paton, which completely disposes of the interpretation placed on the correspondence by the respondent. Despite the fact that this additional letter was made available to the respondent (if it had theretofore been ignorant of it) in petitioner's reply brief before the Circuit Court of Appeals, respondent's counsel now have the temerity again to place before this Court the Paton correspondence, no portion of which is in the record, and again **to leave out any reference to the Receiver's letter** which completely disposes of the alleged admission made by the Receiver, as found in the single letter quoted by respondent.

At page 91 of its brief, respondent quotes from a comment made by Mr. Paton in the August 1923 Journal of the American Bankers Association in reply to an inquiry. At pages 92 *et seq.* respondent quotes from a letter written to Mr. Paton by "the attorneys for the Trustee" (as a matter of fact by the attorneys for the Receiver). In the latter letter it is claimed the Receiver admits that the only question presented by the case now before this Court is whether the admittedly deposited trust funds could be traced into the Receiver's or Trustee's possession.

Reluctantly the petitioner burdens this Court with a quotation from the appendix to the Trustee's brief be-

fore the Circuit Court of Appeals, commenting upon the respondent's use of the Paton material:*

> "In so far as the appellant attempts to rely upon the letter of the receiver and his counsel as an *admission* of the soundness of the position now taken by the appellant, the facts are as follows: After the publication of Mr. Paton's article in the *August* 1923 Journal, counsel for the receiver wrote the letter dated September 20, 1923, from which the appellant has quoted, (although the letter is not in evidence and although of course admissions by the receiver with whom claims are not filed are of not the slightest significance). In reply to that letter and prior to its publication Mr. Paton supplied the receiver and his counsel with proof of his proposed article to appear in the *November* 1923 number of the Journal which article included a quotation in full of the receiver's letter of September 20th. After quoting that letter Mr. Paton, in his consideration of the receiver's position, stated:
>
> > 'The argument of the receiver and his attorney virtually concedes, without prejudice, that where a single remittance is made to a banker for a special purpose and the remittance is mingled with the banker's general fund in his own vaults or in bank which passes to a receiver upon its failure, the purpose not being carried out, the remittance is a trust fund the identity of which is not lost by the mere mingling, but it remains identifiable and recoverable in full if the mingled fund from the time of the receipt of the remittance to the time of the receiver taking possession equals or exceeds the amount of the remittance, or if the fund remaining is less than the remittance, then the trust attaches to what remains.'

*The term "appellant" in the following quotation refers to the respondent in this court.

"In acknowledging the receipt of Mr. Paton's letter with the proof of his proposed article the receiver and his counsel took exception to the assumption made by Mr. Paton, and now again advanced by the appellant, and said in a letter to Mr. Paton, under date of November 5, 1923, *to which the appellant has made no reference*:

> 'In further reply to your interesting letter of November 1st with which you enclose a copy of your opinion in the November number of the Journal of the American Bankers Association, *we wish to take exception* to a statement appearing in the first column of the second page of that opinion, under a heading entitled "Case of Single Remitter."
>
> 'You state that "the argument of the Receiver and his attorney virtually concedes, without prejudice, that where a single remittance is made to a banker for a special purpose, and the remittance is mingled with the banker's general funds in his own vaults or in banks, which pass to the Receiver upon its failure, the purpose not being carried out, the remittance is a trust fund * * *"
>
> 'Without at this time discussing the case involving cable transfers and money orders, and limiting ourselves to the draft situation which was originally involved, **we do not concede the result referred to.** There appears to be little doubt that where as a fact, it is determined that moneys are remitted to the banker for a special purpose, such moneys become trust funds. However, we by no means concede, that a purchaser of a draft in remitting payment therefore is depositing money for a special purpose within that rule of law. In fact, all of the authority which we have been able to find is to the contrary, and we are pleased to refer you to what we consider the leading cases on the subject, to wit:

In re A. Bolognesi & Co., 254 Fed. 770;
Weideman vs. *Newton*, 271 Fed. 302;
Lowell vs. *Brown*, 284 Fed. 936, 941;
Legniti vs. *Mechanics & Metals National Bank*, 230 N. Y., 415.

We thought it best to make this statement to you before your conference with us, so that you might be prepared to discuss this legal question should it arise.'

"Inasmuch as the respondent did not adopt the usual procedure of offering in evidence at the hearing before the Master the letter upon which it now desires to rely and in which it claims is an admission against the estate, the Trustee of course has had no oportunity to place before any Court the letter of November 5th just quoted which clearly shows that even as a matter of pure fact no admission was made by the receiver, 'virtually' or otherwise, immaterial as it might be."

Respectfully submitted,

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